JAPAN AND THE CASPIAN OIL

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In recent years Tokyo has shown a considerable interest in the Caspian oil reserves. This is partly due to a prolonged rise in world energy prices, leading to a growth of return on energy production and encouraging investments, including Japanese, in energy production and transportation. Also, in 2003 the Japanese economy has shown definite signs of recovery from its prolonged recession, with a renewed interest in the new energy sources, in order to ensure a stable growth for the Japanese economy in the 21st century. On the political front, the Japanese ruling elite is convinced that the role of the Caspian states in the country's foreign policy will grow, as indicated in the "Eurasian diplomacy" concept voiced by Prime Minister Hashimoto in 1997.

Japan is alarmed by continued instability in the Middle East. Fifty-five percent of the country's energy resources are accounted for by the imports from the Middle East, whereas 85 percent of oil used in Japan is of Middle Eastern origin,[1] mainly from the UAE, Saudi Arabia, Iran, Qatar and Kuwait. Following the events of 9/11, the subsequent complications in the relations between the West and the oil monarchies of the Gulf; the U.S. military operations in Afghanistan and Iraq, which received a mixed reaction in the Arab world; the claims that America (the senior partner of Japan on the world scene) lays to Iran's nuclear program, and the continued Israeli-Palestinian conflict—prompted Tokyo to seek new energy imports, particularly oil.

It seems that, on the whole, Tokyo's interest in the Caspian oil is prompted by an interest displayed by the Western countries and transnational corporations. Caspian energy resources development is viewed as the most reliable way of including the region in free market and preventing political and economic upheavals, which the West would like to avoid. Energy export revenues should be used to develop the economy of the Caspian states, to ease the transition to a market economy and sustainable economic growth. With regard to international relations, oil revenues should encourage the ruling elites of the Caspian states to provide political stability. In other words, their desire to keep the revenues and their fear to lose them, should help prevent religious and ethnic strife and separatist movements, as plentiful in the Caspian as energy reserves. One of the goals here is to limit Islamic radicalism, in particular, to prevent Iran from solving the Caspian issues, which is seen as one of the pressure points for the Muslim world.

Tokyo is aware that while developing oil and gas reserves in the Caspian, the U.S. is playing "the Caspian Gambit," to build on Brzezinski's "grand chess board" image. This in turn will affect the Caspian countries-Russia relations, while the balance of power in Central Asia and the Caucasus is drifting away from Moscow toward the West. At the same time, it seems that Tokyo's interest in the Caspian is less political than that of the U.S. and Great Britain, whose influence in the region has grown since the

[1] *Financial Statistics of Japan 2001,* Institute of Fiscal & Monetary Policy, Ministry of Finance, Tokyo, Japan.

collapse of the Soviet Union. Japan is less interested in the political games than in promoting its business interests, looking at expected economic gains from energy production projects. For historic reasons, the Caspian is one of the few oil-rich regions outside concession activities of the largest transnational corporations. In fact, their interests are closely connected with those of the oil-importing countries. Apart from the Caspian, new concession zones could be created in Iran, Iraq and the Sahara Desert (in Algeria and Libya) with relatively low operational risks. However, here political barriers remain awesome. As to the Caspian energy reserves, they may in the longer run affect supply and demand for oil on the world markets. In an effort to limit influence of the producer states, Western countries use economic factors to manipulate the situation. Japan, being one of the largest energy importers, is naturally interested in controlling, together with the other players, oil supply and distribution in this resource-rich region.

The Japanese assessments of oil and gas reserves on the Caspian shelf broadly confirm the State Department description of the Caspian as "the second Middle East." According to the analysts of the Japanese National Oil Company (JNOC), the official U.S. estimates of the confirmed oil and gas reserves in the Caspian, as well as possible gas reserves, are broadly objective and correct. However, the JNOC experts believe that hypothetical and, therefore, total reserves, estimated at 200 billion barrels, are exaggerated. Tokyo analysts base their assessments on the latest confirmed reserves data, as well as on the reasonable averages of all the minimal and the maximal forecasts. Using these methods, they have arrived at the following figures for the Caspian reserves: 78 to 100 billion barrels of oil and about seven trillion cubic meters of gas. From this it follows that the potential Caspian shelf reserves are the third or the fourth largest in the world, which implies that their development will greatly influence energy markets in Asia and throughout the world.

Japanese companies are most active in the Azeri sector of the Caspian, the hub of production activities in the region. Baku attracts Japan with its considerable scientific potential and its solid traditions of oil production. Azerbaijan produces drilling and production equipment, as well as equipment for geological surveys, it also has considerable numbers of qualified oil industry workers. The Azeri sector contains a quarter to a third of the proven Caspian shelf reserves, whereas the Russian sector, for instance, accounts for only 1.5 percent. Moreover, Azerbaijan boasts of comparatively developed infrastructure facilities, while transportation is aided by proximity to the Black Sea ports and potential access to the Mediterranean via Turkey. Japanese experts also note ex-President Aliev's role in the history of the Azeri oil industry. Heydar Aliev presided over the national policy of oil production and helped create a stable structural and legal investment environment, where "the rules of the game," once set, were regularly observed.

Today the Japanese capital plays the third, and sometimes, the second role in the Western exploration projects on the Caspian shelf. The Japanese transnational corporations have managed to take part in four out of fifteen production sharing agreements operating off the Azeri coast. The first production sharing agreement in the Azeri sector signed 20 September, 1994 and covering Azeri, Chirag, and Gunashli deposits is one of the best examples of their success in the region. This agreement was signed by the twelve companies, members of the Azerbaijan International Oil Consortium (AIOC). The Itochu Oil Corporation, a Japanese firm, is the ninth member with a 3,9205 percent stake. The controlling stake at over 34 percent belongs to the British Petroleum-Amoco group.

The results of the consortium's activities have exceeded all expectations. Commercial oil extraction began as early as November 1997, while proven reserves reached the figure of 278 million tons.[2] Daily production volumes from twelve producing wells have reached 137 thousand barrels of oil and 2.5 million cubic meters of petroleum gas.[3] Following these developments, Japanese companies widened their participation. On 20 December, 2002, Inpex Southwest Caspian Sea Ltd, a daughter company of the JNOC and Inpex, paid $1,354 billion for LUKoil's 10 percent share in the consortium.[4]

[2] See: *Vedomosti,* 5 June, 2003.
[3] See: *Interfax. Novosti,* 28 April, 2003.
[4] *ITAR-TASS. Novosti,* 28 April, 2003.

Originally the consortium transported its Caspian oil via the northern route, through the Russian port of Novorossiisk. However, this route was abandoned in February 1999 after a failed negotiation between the Russian company Transneft and the Chechen authorities on transit tariffs. To save the project, consortium decided to build a new pipeline, Baku-Tbilisi-Ceyhan. One of the Japanese members of the consortium, Itochu Corporation, considered this decision necessary, "taking into account all the factors."

The new pipeline will be 1,760 km long with an annual throughput flow capacity of 50 million tons. Its completion was expected by the end of 2004, at the total cost of $2.95 billion.[5] Itochu has a 3.4 percent stake in the pipeline.[6] However, the pipeline construction was somewhat delayed, according to the project officials, for environmental considerations.

Tokyo's participation in another production sharing agreement signed 14 December, 1996 and covering Dan Ulduzu and Ashrafi deposits, is considered less successful. These are exploited by the North Apsheron Operating Company (NAOC), in which a Japanese company Itochu Oil Exploration holds a 20 percent stake. Between the end of 1997 and the beginning of 1999 three exploratory wells were built, which showed that commercial oil production is unviable due to low deposits. Exploration was stopped, and the Baku company office was closed, however, the company retained its license to work in the area.

Other Azeri projects with Japanese participation have delivered a similar result. In 1998, Japanese companies signed two more production sharing agreements. Mitsui Company acquired a 15 percent stake for Kurdashi deposit with hypothetical reserves of 500-600 million barrels. The other production sharing agreement was signed between Japan and Azerbaijan and covered the Yanan Tava, Mugan Deniz and Atashgah blocks of deposits. The latter agreement was split into two equal shares. The 50 percent Azeri stake is held by the State Oil Company (SOCAR), while the Japanese stake is split among Japex Corporation with 22.5 percent, Inpex with 12.5 percent and Teykoku Oil and Itochu Oil with 7.5 percent each. The hypothetical oil reserves are estimated at 75 to 90 million tons, with the total project cost of $2.3 billion.

Reportedly, the two exploratory wells drilled in the Yanan Tava and the Atashgah structures at the cost of $100 million, showed no oil or gas deposits.[7] Mr Norihito Sawara, President of the Japan Azerbaijan Operating Company (JAOC), which acts as the project developer, decided to scale down exploration drilling and to review the future of the project in October 2003 when exploration period comes to an end.[8]

Japan has no business interests in the natural reserves of the Turkmen sector monopolized by Western companies. However, two Japanese companies, Itochu Oil Exploration and Inpex have a share in the international Central Asia Gas Pipeline Consortium, linking Yashlar and Keimir gas deposits in Turkmenistan through Afghanistan with Pakistan and possibly India. The pipeline's planned length is 1,492 km, with an annual throughput flow capacity of up to 20 billion of cubic meters. The two Japanese stakes in the project add up to 13 percent. This is just one, and possibly, the least likely, of the five existing or planned options of transporting Turkmen gas. From the start the project was on hold due to the war in Afghanistan. When the U.S. and later international sanctions were introduced against the Taliban regime, Unocal, a U.S. company, which had formed and controlled the consortium with its 54 percent stake, lost interest and left the project. Additionally, several promising gas deposits were found in Pakistan between 1995 and 2000. In this context, and taking into account Pakistan's economic problems, its estimates of demands for Turkmen gas imports are likely to be scaled down. Also, the Japanese are beginning to feel that the project becomes unviable due to the political complications between Iran, on the one hand, and Afghanistan, Pakistan and India, on the other, caused by Tehran's nuclear tests and joining the Comprehensive Nuclear Test Ban Treaty, as well as to a low payment potential of the countries involved.

The oil deposits on the northern part of the Caspian shelf where Kazakhstan sector is located, has seen foreign involvement since 1993. Inpex, a Japanese oil company, joined the Offshore Kazakhstan

[5] See: *Rossiiskaia bizness-gazeta,* 1 April, 2003.
[6] See: *Interfax. Novosti,* 28 April, 2003.
[7] See: *Vremia MN,* 21 March, 2003.
[8] See: *Interfax. Novosti,* 20 June, 2003.

International Oil Consortium (OKIOC) in September 1998. It bought its 7.15 percent share from the Kazakh government, which was going through budget problems due to the financial crisis in Russia and the CIS. At present, there are six foreign companies in OKIOC, and since December 1997 the consortium has been conducting exploratory drilling in the Kashagan and Kerogly deposits with a total area of 6,000 sq km on the basis of a production sharing agreement. With regard to Kazakhstan's oil deposits, the conditions of the Caspian shelf in this sector are different to those of the on land Tengiz deposit. The Japanese experts point out that the northern part of the Caspian is shallow, not exceeding five meters in depth, and exploration here is limited by strict environmental consideration as sturgeon come here for spawning. And unlike in Azerbaijan, local infrastructure does not allow for commercial development of the deposits, which leads to extra costs.

However, the total oil deposits here are estimated at a very high level of 38 billion barrels, with recoverable reserves of 9 billion barrels. Kashagan could become one of the world's largest deposits.[9] If commercial production begins in 2006, it should reach its maximum volume of 1.2 million barrels a day by 2016.[10] The project will probably receive up to $10 billion.

In December 2001, two Japanese firms, Marubeni Trade and Investment Corporation and Nikki Engineering Company, signed a contract with Kazakhoil to redesign the Atyrau oil refinery at the total cost of $250 million, of which $208 million will be provided by the Japan Bank for International Cooperation (JBIC) as a preferential loan. The project was started in 2002 and will be completed by the end of 2005. The aim is to provide equipment for refining oil to produce high-octane gasoline and kerosene. It is also planned to improve the systems for diesel fuel cleaning.[11]

Although Japanese firms take part in the production sharing agreements, the Caspian oil does not actually reach Japan, due to large distances. Instead, the Japanese are using a swap agreement with Indonesia, which supplies them with the equivalent amount of oil.

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The Caspian investment agreements have many parallels in the relations between Russia and Japan. Politically, the main problem of the Caspian is its undefined legal status, while the relations between Russia and Japan are marred by the lack of the peace agreement and the territorial disputes. The Caspian states are aiming to sign agreements on production sharing, shelf development and the construction of Baku-Tbilisi-Ceyhan pipeline, which would bypass Russia. The business relations between Russia and Japan focus on production sharing agreements Sakhalin-1 and Sakhalin-2, as well as joint exploration of the East Siberia oil deposits and the construction of the Angarsk-Nakhodka pipeline, with a diversion to the Chinese city of Daqin. As in the case of the Baku-Tbilisi-Ceyhan pipeline, the Siberian pipeline project is also complicated by environmental issues. In practical terms, the Caspian states need to cooperate in order to fight sturgeon poaching, while Moscow and Tokyo focus on cooperation to stop poaching and illegal sales of the sea products, which harm the bioresources of the Pacific. In 2002, Russia, for the first time in many years, conducted military exercises in the Caspian, in order to fight poachers and to prevent terrorist activities. In 2003, the Pacific Fleet conducted similar exercises, although on a larger scale in the Far East.

These parallels are not random. They show that, in order to protect its interest in the Caspian, as well as in the Far East, Russia needs a clear state policy and a political will for its implementation.

[9] See: *Vedomosti,* 9 September, 2003.
[10] See: *Interfax. Novosti,* 4 September, 2003.
[11] See: *Nihon Keizai Shimbun,* 5 December, 2001.